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CONVENTION WITH GREAT BRITAIN AND NORTHERN IRELAND WITH RESPECT TO TAXES ON INCOME

FRIDAY, MAY 10, 1946.—Ordered to be printed

Mr. LUCAS, from the Committee on Foreign Relations, submitted the following

REPORT

[To accompany Executive D, Seventy-ninth Congress, first session]

The Committee on Foreign Relations has had under consideration Executive D, Seventy-ninth Congress, first session, a convention between the United States of America and the United Kingdom of Great Britain and Northern Ireland, for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on April 16, 1945.

This is the second time this convention has been considered by this committee. It was first referred to this committee on April 24, 1945. Thereafter it was made the subject of extended consideration by a subcommittee, in the course of which the subcommittee held public hearings on May 23, and June 13, 1945. The convention was favorably reported to the full committee under date of June 30, 1945, and the full committee made a favorable report to the Senate on July 3, 1945, Executive Report No. 6, Seventy-ninth Congress, first session. For the information of the Senate there is appended hereto and made a part of this report the report of the Committee on Foreign Relations referred to.

On February 6, 1946, however, the convention with its related Executive E, a convention relating to estate taxes between the United States and the United Kingdom, was recommitted to the committee for further hearings with respect to (*a*) certain objections raised with respect to paragraph (3) of article XI of the convention and (*b*) the application of article XIV of the convention to the problem of taxation of so-called refugee aliens present in the United States.

These latter problems have been considered by a subcommittee of the Committee on Foreign Relations and hearings were held before that subcommittee on April 17, 1946, for the purpose of hearing interested persons. The report of the subcommittee on these points is also appended hereto and made a part of this report.

It will be seen from such subcommittee report that the subcommittee recommends (*a*) that the convention be ratified without amendment; (*b*) that the objections taken to the presence in the convention of paragraph (3) of article XI are sound; and (*c*) that appropriate steps be taken, after ratification, looking to striking such paragraph from the convention. The subcommittee is satisfied with assurances given it that the appropriate agencies of the two Governments will cooperate in the drafting of a protocol to the convention designed to accomplish the purpose in (*d*), which protocol will, in due course and at the earliest practicable date, be presented to the Senate, the amendment thus made to the convention taking effect as at the effective date of the convention itself.

The full committee concurs in the views of the subcommittee and hereby report the convention favorably to the Senate without amendment and recommend that it advise and consent to its ratification.

UNITED STATES SENATE,
COMMITTEE ON FOREIGN RELATIONS,
Washington, D. C.

REPORT OF SUBCOMMITTEE ON EXECUTIVE D, SEVENTY-NINTH CONGRESS, FIRST SESSION (A CONVENTION BETWEEN THE UNITED STATES AND THE UNITED KINGDOM FOR THE AVOIDANCE OF DOUBLE TAXATION OF INCOME, ETC.)

Hon. TOM CONNALLY,
Chairman, Committee on Foreign Relations,
United States Senate, Washington, D. C.

DEAR SENATOR: The subcommittee appointed to study and report on Executive D, Seventy-ninth Congress, first session (a convention between the United States of America and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed at Washington on April 16, 1945), reported back to the full committee on June 30, 1945, with recommendation (Executive Report No. 6, Seventy-ninth Congress, first session). Such report is readopted by this subcommittee as its report, subject to the qualifications thereto resulting from the recommittal of Executive D to the Committee on Foreign Relations as set forth below. On February 6, 1946, Executive D was recommitted to the Committee on Foreign Relations for further hearing. The subcommittee appointed to study and report on Executive D as a result of the recommittal hereby report back to the full committee with recommendation.

The issues constituting the basis for recommittal of Executive D, as set forth above and considered by your subcommittee, are as follows:

(*a*) The question of striking from the convention paragraph (3) of article XI thereof; and

(*b*) The application of article XIV to the taxation of so-called refugee aliens present in the United States.

With respect to (*a*) your subcommittee believes that there exist substantial grounds for the view which has been urged upon it that

paragraph (3) of article XI is open to the objection that it is discriminatory in that the reciprocal exemption, granted under paragraphs 1 and 2 of the article by each of the contracting countries with respect to compensation for personal services performed within such country by a resident of the other country, is denied to actors, musicians, athletes, and other public entertainers. While the operation of the credit given by one of the Governments for the tax which may be imposed upon such compensation in the case of such individuals by the other Government does in fact avoid double taxation, it, nevertheless, appears that the paragraph does draw a distinction between persons falling within its scope and persons falling without it, denying, as it does, the exemption to the former class and allowing it to the latter. In addition, the number of taxpayers concerned is small, and the net balance of revenues resulting from the elimination of the paragraph is actually and relatively small and hence, such elimination is not objectionable from the revenue standpoint of the United States.

In any instance in which the United Kingdom imposes a tax on the earnings of an American actor in England, the United States would allow a credit, thus reducing our revenue and offsetting to this extent the United States tax on the British actor. Your subcommittee, therefore, while fully mindful of the desirability of prompt and favorable action upon the convention as drawn and in view of the fact that the British Government ratified the convention many months ago, sought means designed to bring about the elimination of the objectionable paragraph without impeding Senate action on the convention. Assurances have been given your subcommittee that the appropriate branches of the two Governments are now engaged in the drafting of a protocol to the convention and the taking of necessary steps incident thereto for the elimination of such paragraph. The protocol will, in due course and at the earliest practicable date, be submitted to the Government of the United Kingdom, the executive branch of which has, after consultation, signified its willingness to sanction such provision, and to the Senate. Such protocol will, when adopted, have retroactive effect to the date of the convention itself. It is, therefore, recommended by your committee in this regard that the convention be ratified as now drafted in the light of the assurances thus given.

With respect to (*b*) it will be seen by reference to Executive Report No. 6 (p. 4) that at the time such report was made the Bureau of Internal Revenue had under investigation, on a comprehensive scale, the taxable status of refugee aliens in the United States, and the appraisal of the scope of the problem and its relation to article XVI of the proposed convention. In the meantime such investigation is in process of being concluded and the results thereof in the form of a report are spread upon the hearings before your committee incident to its reconsideration of the convention. (See p. 116 et seq., hearings.) From a study of such report and discussions based thereon, the members of your committee believe that the so-called refugee-alien taxation question is a relatively minor problem, and do not regard it as having any appreciable bearing upon action with respect to the proposed convention. For the information of the Committee the report of the Bureau relating to investigation of refugee aliens is attached hereto and made a part of the report of the subcommittee.

We believe that the terms of the convention are, on the whole, advantageous to the United States and that the convention should be ratified.

Respectfully submitted.

SCOTT W. LUCAS, *Acting Chairman.*

MEMORANDUM CONCERNING INVESTIGATION OF ALIEN TAXATION

ORIGIN OF PROBLEM

Beginning about May 1945 there appeared in the press a series of articles questioning the sufficiency of the existing income-tax law as applied to aliens who were physically present in the United States. The articles referred to "refugee stock traders" or "guest speculators" and the like who as war refugees in the United States were reaping allegedly tax-free profits in this country, especially in their transactions on domestic stock and commodity exchanges. Some writers suggested that such profits might be as high as $800,000,000 on which the minimum tax would be about $200,000,000. In connection with a legislative measure pending before the Ways and Means Committee and an income-tax convention pending before the Senate Foreign Relations Committee, consideration was given to possible enabling legislation but action was suspending pending further check concerning the adequacy of existing law.

APPLICABLE STATUTORY PROVISIONS

There are outlined below the provisions of existing law, including tax conventions, which are the subject of the present controversy.

For Federal income-tax purposes aliens are classified into resident and nonresident aliens and the latter are subclassified as between those (*a*) not engaged in trade or business in the United States and (*b*) those engaged in trade or business therein. An alien resident in the United States is, like the citizen of the United States, taxed on his income from all sources, including his capital transactions. However, in the operation of the credit provisions contained in section 131 of the Internal Revenue Code he may be denied credits for foreign taxes paid which are granted to the citizen.

The nonresident alien not engaged in trade or business in the United States is taxed on all his fixed or determinable annual or periodical income from sources within the United States, such as dividends, interest, rents, and royalties, but is exempt from tax on any gains from his transactions in stocks, securities, or commodities through a United States resident broker, commission agent, or custodian. The exemption thus granted to aliens in this category and on this class of transactions takes account, inter alia, of the rate of tax (imposed on a gross basis) on such periodical items of income and such administrative questions as the impracticability of determining and enforcing a tax against such aliens incident to their transactions clearing through our domestic exchanges. House Report No. 2475 and Senate Report No. 2156 on the revenue bill of 1936 recognize the collection difficulties involved in this type of case.

The system of levying a gross tax on items of fixed and periodical income, with accompanying provisions for collection at source, has proven very successful since its adoption in 1936, not only from an administrative but also from a revenue point of view. The tax collected in this class of cases in 1943, the latest year for which complete statistics are available, was about $50,000,000 which exceeds by many times collections from such class of taxpayers under previous principles of taxation.

Under existing statutory provisions the nonresident alien is not subject to tax on capital gains merely by reason of his transactions in stocks, securities, or commodities through a resident broker, commission agent or custodian, but he is subject to tax on such gains if he is otherwise engaged in trade or business in the United States and most any sort of activity in this respect, including the performance of personal services within the United States at any time during the taxable year, constitutes engaging in trade or business. However, it should be observed that with respect to countries with which we have income-tax conven-

tions (Canada, France, and Sweden), this particular phase of alien taxation is modified to provide that residents of those countries (other than United States citizens) are not subject to tax on capital gains unless they have a permanent establishment in the United States. This forms a part of the permanent establishment base used elsewhere in the conventions, and the base so employed with those countries has been made a part of the pending convention with the United Kingdom. The adoption of the permanent establishment principle has been found in the course of the investigation referred to below to have little effect on cases involving nationals of Canada, France, Sweden, or the United Kingdom. Thus out of 12 cases of British subjects involving potential deficiencies of about $60,000 none is affected by the permanent establishment principle. Also in the case of eight French citizens involving proposed deficiencies of about $500,000 the outcome of only one deficiency of about $250 seems to be dependent on whether the individual had a permanent establishment in the United States. No cases of Canadian or Swedish nationals involving this principle have been discovered.

SCOPE OF INVESTIGATION

The investigation referred to above as to the adequacy of existing law was opened by the issuance of Commissioner's Mimeograph No. 5883, dated June 27, 1945, for the information of the public and Bureau personnel and contained a careful analysis of the operation of existing law. The Commissioner accompanied such mimeograph by a press release calling attention to the narrow scope of the exemption granted to nonresident aliens deriving income from United States sources and directing that close scrutiny be made of all claims for exemption. Noncitizens were also asked to consult with appropriate Bureau officials in order to have their tax status clarified and their attention was called to the provisions of existing law which require departing aliens to obtain tax clearance before departure. As a part of the general assistance and investigative plan, intended to assure fair and proper treatment under existing law and to provide data which might afford a basis for legislative or administrative improvements, a questionnaire (Form 1044) was prepared and issued in order to elicit all pertinent facts bearing on the question of proper classification of noncitizens for taxation purposes. The form did not ask merely that the noncitizen claiming exemption state certain conclusions of law or fact respecting his status but was of searching character intended to bring out all his activities from which the Bureau could form its own conclusions.

Although the investigation was of comprehensive scope and one of continuing application, activities were centered largely on certain groups in which the Bureau had the most immediate interest. Thus, there were first brought under investigation those aliens who brought with them or otherwise transferred property in considerable amounts into the United States. With the cooperation of officials of the New York Stock and Commodity Exchanges, Bureau agents examined all accounts in such exchange houses of the above and any other groups who had engaged in transactions on those exchanges. In making such check there were set aside all accounts of noncitizens who were subclassified as between resident and nonresident aliens. Altogether in excess of 700,000 accounts were examined and from these about 15,000 accounts of noncitizens were located. Similarly, a check was made of all custody, safekeeping, and investment agency accounts in the banks of the New York area and from this check a list of 5,000 noncitizen accounts was compiled. Cases were also located through standard Bureau procedure and a good many names of aliens sent in by the public or mentioned in the press were included in the Bureau's investigation. As a part of the plan it was necessary to eliminate duplications incident to one party having an account with more than one brokerage or financial house and also to transfer a good many cases from one district to another because of changes in addresses. Upon making such adjustments there remained for investigation in the New York area alone about 12,200 cases and for the country as a whole about 15,000 cases.

Satisfactory methods of cooperation having been perfected between the Bureau and the New York brokerage and banking institutions, the Bureau field offices were asked to enter into similar arrangements with such institutions in their respective territories. A similar spirit of cooperation was found to exist in such territories; in fact, the program was greatly facilitated in the New York and other areas by the publicity and public interest which it attracted.

RESULTS OF INVESTIGATION

The investigation to date has uncovered 79 cases where dispute exists as to whether the noncitizen is a nonresident or resident of the United States or whether he was engaged in trade or business within the United States. The amount of taxes proposed by the Bureau in such cases is $3,953,253 attributable to a variety of causes which are difficult to summarize. However, the two largest deficiencies amounting to about $1,500,000 and $500,000, respectively, are proposed against former citizens who, after renouncing their citizenship, have been in the United States since the early days of the war. The deficiencies in these cases may be attributed almost entirely to causes other than capital transactions; 5 of the 79 cases account for about $2,900,000 of the total proposed deficiencies. Out of the 79 cases 43 involving $3,579,339 in proposed deficiencies, are situated in the New York area. These cases were located as the result of processing about 10,500 cases. Of the 10,500 aliens investigated about 80 percent were found to have filed returns on the basis of being resident in the United States or engaged in trade or business therein, thus conceding that they were subject to tax on their income from capital transactions in the United States. About 15 percent of the group of 10,500 cases were found not to merit further investigation because of the small amounts involved. About 3 percent of the remaining 5 percent are classified principally as resident aliens not required to file returns because their income was less than allowable exemptions. The balance is composed of nonresident aliens not engaged in business in the United States who were not required to file returns because their taxes had been fully satisfied at source and nonresident aliens who had filed returns reporting their taxes which had not been fully satisfied at source. Only a few of such nonresidents were found to have been in the United States during the taxable periods involved and their stays here were of very limited duration. Of the 12,200 potential noncitizen taxpayers in the New York area about 800 have not yet been contacted and about 900 cases are still in process of audit. After giving special attention for the past several months to cases where there was delayed response to Bureau letters, it has been found that such delay was in nearly all instances due to ordinary causes, such as changes in address, so it is not anticipated that the group of 800 cases will be productive of substantial deficiencies; in fact, based on past experience, it is thought that practically all of these cases will be dropped because of the small amounts involved. Moreover, considering that all cases where contacts had been made were examined in selecting the 43 cases, representing those where deficiencies were most likely to develop, it is not believed that substantial deficiencies are likely to be uncovered in the final audit of the group of 900 cases.

Altogether it seems that the figure $3,953,253 is not likely to be increased when the 79 cases are finally adjusted. It is known that adjustments will be upward in some cases when the years 1944 and 1945 are considered but it is also known that in computing tentative taxes making up the $3,953,253 figure gross income has been used in many instances, pending ascertainment of the cost of securities and other deductible items, and that, pending further investigation as to the time the capital assets were held, tax has been computed on the basis of short-term gains. It also seems unlikely that the Government will be successful in asserting its claim of residence or engaged in business in all cases. However, even if the figure $3,953,253 were doubled to take care of the above and other contingencies, such as the discovery of new cases, it would still be quite small from a revenue point of view considering the amount of effort which has been put into the project. In this general connection, the current additional taxes being asserted as the result of audits of other cases and other investigative projects of the Bureau are now exceeding $1,000,000,000 per year.

SUMMARY OF INVESTIGATION

The claims made in the press and financial circles that aliens present in the United States were engaged in business transactions on substantial basis in this country, especially on our exchanges, seem to have been well founded but there seems to be little justification for the charge that they have attempted to avoid taxation under the provisions of existing law. On the contrary, the studies indicate that all except a comparatively small number of the aliens having any potential liability have heretofore filed tax returns on the basis of being resident

in the United States or engaged in trade or business therein, thereby admitting that they are subject to tax on their capital transactions in this country. As with respect to citizens, errors may be found upon audit of their returns but it is important to note that they have not tried to hide or to avoid their responsibilities under our tax laws. Moreover, a test check made of the more important returns filed indicates that the percentage of accuracy and error is comparable to that found in the returns of citizens. Even in the 79 cases many of the aliens had filed returns on a nonresident basis.

However, aside from the immediate results of the investigation, reflected primarily in the 79 cases, there are certain over-all considerations which should be mentioned. Although such immediate results have been quite negligible from a revenue point of view, the matter of alien taxation becomes active every few years and it is believed that the statistics gathered will be found to be of substantial benefit for future legislative and administrative purposes. Also, upon considering the publicity given to the investigation and the thoroughness with which the alien field was combed, it is believed that the program is entitled to credit for certain indirect benefits looking toward a better understanding and enforcement of taxes in the alien field.

PRIOR LEGISLATIVE CONSIDERATIONS

This subject is reflected primarily in H. R. 3138, May 7, 1945; the report of the Committee on Foreign Relations concerning the proposed income-tax convention between the United States and the United Kingdom (executive report No. 6, July 3, 1945, 79th Cong., 1st sess.); and in the discussion between Senator McMahon and Senator Maybank on the subject of alien taxation (vol. 91, July 19, 1945, 79th Cong., 1st sess., pp. 7916–7919). The legislative changes considered were those involving (1) a statutory definition of "residence" and (2) a modification of the existing statutory definition of engaging in trade or business. In executive report No. 6 the conclusion was reached that any statutory definition of residence would be equally applicable to cases coming within the pending convention with the United Kingdom, since residence is not defined in such convention. The conclusion was also reached that although a change in the definition of what constitutes engaging in trade or business might not affect all cases coming within such convention there were important compensating factors. In the course of discussion between Senator McMahon and Senator Maybank the former stated, in effect, that although he was first inclined to feel that the importance of the subject was such as to warrant the consideration of an amendment to existing law to define what constitutes "residence" he had since concluded that the defect was not so much a matter of statutory law as of interpretation thereof and that upon careful study of the revised rulings of the Treasury in this regard he was not prepared to say that the situation had not been taken care of. Senator McMahon also gave assurances to Senator Langer that the revised rulings of the administrative branch would be applied retroactively to cover those aliens who had been in the United States during the war period; and, it should be added, that such rulings have been so applied and their application so reflected in the above-mentioned results of the recent drive. It should also be noted that, for the reasons above stated, any interpretation of residence by the administrative or judicial branches is equally applicable to our several income-tax treaties.

Although considerable attention has heretofore been given to the legislative approach to a solution or improvement of the problem, the purpose of the present memorandum is merely to set forth the facts recently ascertained by the Bureau with respect to the taxability of income, particularly capital gains, derived from sources within the United States by refugee aliens. It is thought that further development of the subject would be somewhat premature until the interested committees of Congress have had an opportunity to consider the recent factual development of the problem.

Noncitizen taxpayers' cases assigned, New York area field divisions, as of Apr. 15, 1946

	Second New York	Upper New York	Brooklyn	Total
Total letters mailed	1,461	8,517	2,658	12,636
Replies received [1]	1,414	8,208	2,658	12,280
No reply	47	309	None	356
Replies received	1,414	8,208	2,658	12,280
Transferred	16	218	166	400
Replies to be accounted for	1,398	7,990	2,492	11,880
Replies to be accounted for	1,398	7,990	2,492	11,880
Cases in process	231	614	62	907
Investigation completed	1,167	7,376	2,430	10,973
Result to date:				
Closed, no change [2]	617	682	2,127	3,426
Closed, survey [3]	513	6,657	271	7,441
Total closed	1,130	7,339	2,398	10,867
Changes made or proposed	37	37	32	106
Total	1,167	7,376	2,430	10,973

Letters mailed out	12,636
Cases transferred	400
Cases retained	12,236
No reply	356
Cases to be investigated	11,880
Cases in process	907
Cases processed	10,973
Closed, no change	10,867
Changed cases	106

[1] Or (*a*) nonresidence, (*b*) income less than exemption, verified from reliable source.
[2] After verification as to nonresident status or, if resident, examination of returns.
[3] Found unworthy of examination of resident returns or, if no return, account too small to warrant further investigation.

Executive Report No. 6, Seventy-ninth Congress, first session, submitted by Mr. Lucas on Tuesday, July 3, 1945, follows:

The Senate Committee on Foreign Relations, having had under consideration Executive D, Seventy-ninth Congress, first session, a convention between the United States of America and the United Kingdom of Great Britain and Northern Ireland, for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on April 16, 1945, hereby report the same favorably to the Senate without amendment and recommend that it advise and consent to its ratification.

For the information of the Senate, there is appended hereto, and made a part of this report, the report of the subcommittee under date of June 30, 1945. There is also appended for the information of the Senate the message from the President, transmitting the convention and the accompanying report of the Secretary of State.

UNITED STATES SENATE,
COMMITTEE ON FOREIGN RELATIONS,
Washington, D. C., June 30, 1945.

REPORT OF SUBCOMMITTEE ON EXECUTIVE D, SEVENTY-NINTH CONGRESS, FIRST SESSION (A CONVENTION BETWEEN THE UNITED STATES AND THE UNITED KINGDOM FOR THE AVOIDANCE OF DOUBLE TAXATION OF INCOME, ETC.)

Hon. TOM CONNALLY,
Chairman, Committee on Foreign Relations,
United States Senate, Washington, D. C.

DEAR SENATOR: The subcommittee appointed to study and report on Executive D, Seventy-ninth Congress, first session (a convention between the United States of America and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed at Washington on April 16, 1945), hereby report back to the full committee with a recommendation.

Incident to your subcommittee's consideration of the proposed convention, four certain questions have attracted its special attention, namely:

(1) The desirability of transmitting to the Senate for its advice and consent any contemplated extension of the proposed convention to a British colony or to a United States possession, as the case may be;

(2) The relation of the provisions of the convention to our domestic principles of taxation of capital gains (primarily stocks, securities, and commodities) as applied to the alien resident in the United States and the nonresident alien who is engaged in trade or business in the United States;

(3) Whether the proposed convention should be regarded as a precedent for future conventions with other countries;

(4) The desirability of affording to business and its representatives an opportunity to present to the executive departments concerned, preliminary to any tax conventions discussions with any foreign country, taxation problems existing with respect to such foreign country.

The problem in (1) relating to affording an opportunity of review by the Senate of contemplated adherence to the convention of any colony, overseas territory, or other areas over which one of the contracting countries exercises authority has been discussed with both the State and Treasury Departments. As a result, the committee is now in receipt of the following letter from the Secretary of State in which it is set forth that the State Department will recommend to the President that any such formal declaration under article XXII by either country will be transmitted to the Senate for its advice and consent before admitting such colony or such possession within the framework of the convention. Your subcommittee views such arrangement as entirely satisfactory and as laying the basis for working out the problem satisfactorily as it arises.

JUNE 27, 1945.

Hon. TOM CONNALLY,
Chairman, Committee on Foreign Relations,
United States Senate, Washington, D. C.

MY DEAR SENATOR CONNALLY: Reference is made to discussions before a subcommittee of the Committee on Foreign Relations regarding the convention between the United States of America and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on April 16, 1945 (Senate Executive D, 79th Cong., 1st sess.).

During those discussions a question was presented respecting the procedure to be followed by this Government in accepting or giving a notification of extension of the convention, under the provisions of article XXII thereof, to colonies, overseas territories, or other areas over which one of the contracting parties exercises authority. I am glad to inform you that in connection with any such notification of extension of the convention, the Department of State will recommend to the President that the matter be submitted to the Senate for its advice and consent before any notification of extension is accepted or given on behalf of the United States.

Sincerely yours,

JOSEPH C. GREW, *Acting Secretary.*

With respect to the taxation of capital gains, where the alien is found to be resident in the United States he is under existing law taxed on his income from all sources, including his capital gains, but where he is found to be a mere transient, or sojourner, or for other reasons not resident in the United States, he is not taxable on his capital transactions unless he is engaged in trade or business in the United States. The convention does not disturb the existing residence principle but does contain some modification of taxation on the basis of being engaged in trade or business, in that the test prescribed in the convention is whether the alien has a permant establishment (branch, agency, or other fixed place of business) in the United States as distinguished from being engaged in trade or business therein. Although an alien having a permanent establishment in the United States would in nearly all cases be engaged in business therein, certain cases could arise where he could engage in trade or business without having a permanent establishment and in such instances he would be exempt from tax on capital gains. Respecting this variation, however, there is an important compensating factor, in that it is not practicable to trace, in the absence of the convention, transactions on the United States exchanges carried on through British brokers by a British resident who under existing law is classed as being engaged in business in the United States. Under the convention, however, the means have been provided, through exchange of tax information, to ascertain the British resident having a permanent establishment in the United States and to locate and tax his transactions on the United States exchanges even though carried on from sources in Britain. Thus there has been substituted for a theoretical and ineffective basis of taxation a more realistic and effective one.

The effect of the permanent establishment principle on British methods of taxation on the securities and commodities exchanges was also considered. Comparisons between the United States and British systems respecting taxation of such transactions become somewhat involved because of the divergent taxation concepts of the two countries but the following more important principles are noted: A United States citizen, regardless of his place of residence or domicile, can deal on the British stock or security exchanges free from British tax unless his transactions are under British law regarded as trading

profits, and the permanent establishment provision of the convention does not modify this principle. The United States law as modified by the permanent establishment principle is less liberal, in that the British resident upon having a permanent establishment in the United States is taxable on profits from his transactions on the exchanges. For example, the United States lawyer or engineer having a branch office (permanent establishment) in London could deal extensively on the London exchanges without being subject to British tax on his resulting profits while the British lawyer or engineer with a branch office in the United States would be subject to United States tax on profits from exchange transactions in the United States. Thus, in such instances the United States taxes its citizen on his profits on the British exchanges and the British resident having an office or other form of permanent establishment in the United States on his profits on United States exchanges. Since Britain in such instances imposes no tax the United States tax is not reduced because there is no credit for the nonexistent British tax. It is again noted that the convention makes provisions for the exchange of information so that the United States is in a better position to follow the transactions of its citizens and residents on the British markets and, where pertinent, of the transactions of British residents on the United States markets.

There are other instances, however, where in practice the permanent-establishment concept adopted in the convention may overlap. Thus, if a United States bank with a branch in London should sell securities on the London exchange it would be subject to British tax since it would have a permanent establishment in Britain and its sales of securities would be regarded as part of the trading profits of the bank. On the converse side, the United States would also tax profits of a British bank having a branch in the United States. It is also noted that in the first illustration the United States tax would be reduced by a credit for the British tax under the existing United States law and the convention and in the second illustration the British tax would be reduced by the United States tax under the convention which modifies British law in this regard.

In considering this general subject, the subcommittee is aware of the fact that the Bureau of Internal Revenue has under active investigation the taxation of capital transactions of refugee aliens in the United States and the possibility of legislation, if found necessary, to supplement such program. As above indicated, there may be certain cases falling in between the test of being engaged in trade or business and having a permanent establishment where the convention is more liberal than existing law, but there are other compensating factors and no such technical conflict exists where the test of taxation is residence. Moreover, the same provisions found in the British convention are now in effect under the conventions with Canada, Sweden, and France.

It is believed that satisfactory reconciliation has been made between technical principles of the two systems, and that the adjustments agreed upon are, on the whole, advantageous to the United States, especially when the provisions relating to exchange of tax information are considered.

With respect to the third point, your subcommittee has been given to understand that neither this convention nor any of our existing conventions are regarded by the executive branches concerned as precedents for future tax conventions. The conditions encountered

in negotiations with foreign countries are found to vary widely as between the respective countries and thus any specific provisions found in one convention may not be found, from the United States standpoint, to be acceptable in a convention with another country. A concession made to a particular country by the United States in a tax convention with such country may not be made in the case of another country in the absence of compensating concessions by such country.

With respect to (4) it is the understanding of your subcommittee that the executive departments concerned have in the past encouraged American business interests to present their views relating to taxation problems with foreign countries and that, wherever practicable, such policy will in the future be expanded. It is understood, however, that many foreign countries are disinclined to publicize the advent of their negotiations with other countries. To the extent that such and other like considerations will permit, your subcommittee is satisfied that every effort will be made to invite expression of views by domestic interests involved prior to undertaking future tax negotiations. In this regard, the executive departments concerned are anxious in the interests of tax conventions effecting their purposes, of being fully informed of all taxation problems existing between the United States and any foreign country with which it proposes entering upon negotiations.

We have had the benefit of testimony by the Chief of Staff, Joint Committee on Internal Revenue Taxation, and a representative of the Treasury Department as well as a technical memorandum submitted by the Treasury Department, all of which have received careful study.

We believe that the terms of the convention are on the whole advantageous to the United States, and that the convention should be ratified.

We further believe, however, that in the interest of promoting closer coordination between future income-tax conventions and taxation measures or studies, which may be pending or under consideration in Congress, closer cooperation be established in this regard between the appropriate executive and legislative branches.

For the information of the committee, the memorandum referred to is attached hereto and made a part of the report of the subcommittee.

Respectfully submitted.

ALBEN W. BARKLEY.
CARL A. HATCH.
SCOTT W. LUCAS.
ROBERT M. LA FOLLETTE, JR.
WALLACE H. WHITE, JR.

TECHNICAL MEMORANDUM OF THE TREASURY DEPARTMENT ON THE CONVENTION

There is transmitted herewith for your consideration with recommendation that it be approved and transmitted in due course to the Department of State, the draft of a proposed income-tax convention between the United States and the United Kingdom. Such convention had its inception in discussions at London beginning in April 1944, which were resumed at Washington during November, and

represents the culmination of developments since prior exploratory discussions in London in 1937.

The proposed convention represents the first instance in which the United Kingdom is party to a convention of comprehensive scope corresponding in subject matter substantially to the existing bilateral conventions between the United States on the one hand and Canada, Sweden, and France on the other.

ARTICLE I

This article enumerates the taxes with which the convention is concerned in general. Where any given article is inapplicable to one or more of such taxes the article so states. The article contains the usual provisions that the convention will apply to other taxes of substantially similar character imposed by either contracting party or by a territory concerned subsequent to the date of signature of the convention.

ARTICLE II

This article defines various terms used in the convention. Clauses (a), (b), and (c) are routine and appear to require no specific consideration. Clauses (g) and (h) are of vital importance and constitute the key to the application of articles III, VI, VII, VIII, IX, XI, XII, and XIV. Thus it will be observed that the term "resident of the United Kingdom" excludes a citizen of the United States, a resident of the United States and a United States domestic corporation. Hence, a citizen of the United States and a United States domestic corporation even though actually resident in the United Kingdom remain subject to United States tax upon dividends, interest, rents, royalties, and business income as though the convention had not come into effect. If, however, a corporation organized, for example, under the laws of France is managed and controlled in the United Kingdom, such corporation constitutes a resident of the United Kingdom and is entitled to the exemptions or partial exemptions provided in the cited articles. Thus such corporation selling its manufactured goods in the United States through a broker or commission agent in the United States and having no branch or other installation in the United States will be exempt from United States tax upon its business income from United States sources. On the other hand a corporation organized under the laws of the United Kingdom but having its control and management in, for example, India, is not entitled to such exemption. However, article V relating to shipping and aircraft profits should be contrasted in this regard.

On the other hand a resident of the United States (whether or not a United States citizen) and a United States domestic corporation not resident in the United Kingdom is entitled to exemption from United Kingdom tax as to its business income if it sells its products on the English market through a broker or commission agent in the United Kingdom. These exemptions will be more fully treated in the various articles upon which article II and the definitions therein found have, as already pointed out, a most important bearing.

The definitions of "United Kingdom enterprise" and "United States enterprise" tie into "residents of the United Kingdom" and "residents of the United States," respectively.

The definition of "permanent establishment" found in clause (l) corresponds to, and is substantially identical with, that contained in clause (f) of the protocol to the Canadian convention and to paragraph (1) of the protocol to the existing Swedish convention.

Paragraph (2) of the article, when read in association with articles VI, VII, VIII, IX, and XIV, has the effect as will be more fully dealt with under those respective articles, of rendering applicable the exemptions there provided in the case of individuals performing personal services within the United States or the United Kingdom, as the case may be, even though such individuals are engaged in trade or business therein by reason of the performance of such services.

ARTICLE III

This article corresponds to article I of the Canadian, to article II of the Swedish, and to article 3 of the existing French, convention and follows the principle of "permanent establishment" in the field of business income. Under such principle, the United States will, upon a reciprocal basis, subject to such taxation the business income of a United Kingdom enterprise only if such enterprise has a permanent establishment in the United States. The article has application only to business income, or "industrial and commercial" profits as it is designated in the convention. The article has no application, for example, to investment income or income arising from the rendition of personal services, which items are in terms exempt from tax in whole or in part in accordance with separate articles of the convention and, in the absence of such rules with respect to any particular item, by the Internal Revenue Code. Clauses (g), (h), (i), (j), (k), and (l) of article II should be read in association with article III, since such clauses define "resident of the United States," "resident of the United Kingdom," "enterprise of one of the contracting States," and "permanent establishment." The effect of these definitions upon taxation by the United States or by the United Kingdom is traced under article II in the consideration of the definitions.

It will be observed from a reading of paragraph (2) of article III that the United Kingdom reserves from the application of the article those provisions of her excess-profits tax and her national defense contribution under which the profits of the United States subsidiary corporation are consolidated with those of its United Kingdom parent corporation and could not see fit to waive her taxes of the subsidiary profits even though the subsidiary had no branch or other installation in the United Kingdom (see Finance Act of 1940, fifth schedule, pt. I).

The principles of taxation found in article III thus are recognized and followed in the three existing conventions to which the United States is a party and are substantially in harmony with existing United States law. For a more detailed treatment of such, see Executive Report No. 18 (pp. 6 and 7) relating to the Swedish convention, a copy of which report is attached hereto.

ARTICLE IV

This article corresponds to article IV (1) (a) of the Canadian, to article III of the Swedish, and to article 5 of the French, convention. It recognizes the principle found in section 45 of the Internal Revenue Code to adjust the accounts as between interlocking businesses and supplements paragraph (3) of article IV [illegible]

allocation of business income as between the two countries to the end that a reasonable tax basis will be allocated to each. From the United States side there will be framed regulations corresponding to section 7.25 of Treasury Decision 5206, approved December 31, 1942, being regulations under the tax convention between the United States and Canada.

ARTICLE V

This article provides for the reciprocal exemption of earnings derived from the operation of ships and aircraft. It has application only to business income from such activities and has no application to dividends which might be paid by a corporation engaged in whole or in part in maritime or aircraft operations. Insofar as the article concerns maritime operations it conforms to the reciprocal exemption which has existed for more then 20 years between the two countries and is based upon exchange of notes dated at various times from 1921 to 1924. Insofar as it concerns aircraft operations, it represents an objective, the accomplishment of which has been frequently desired by the Department and which has been embodied in all other income-tax conventions to which the United States is a party.

It will be observed that the article applies to corporations organized under the laws of the United Kingdom and to corporations organized under the laws of the United States regardless of the place where such corporations are managed or controlled. This principle was agreed upon in order to adhere to the provisions underlying the existing reciprocal exemptions of shipping profits.

ARTICLE VI

Under this article the nonresident alien residing in the United Kingdom, the foreign corporation controlled and managed in the United Kingdom, and the trust or partnership in the United Kingdom will be subject to United States tax at the flat rate of 15 percent upon dividends from sources within the United States if such individual, corporation, or entity is not engaged in trade or business in the United States at any time during the year in which such dividend is paid. When read in association with article II (2) it will be seen that such alien, even though he performs personal services within the United States in such taxable year, is entitled to the reduced rate of tax. Thus, assuming that A, a British subject residing in the United Kingdom, performs personal services in the United States for a period of 4 months in 1945 as a consulting engineer employed by a United States domestic corporation and is paid compensation therefor of $10,000. A holds 100 shares of X company stock on which he received in 1945 dividends amounting to $900. Such dividends are subject to tax at the rate of 15 percent. His earned income is subject to tax under sections 11 and 12 after allowance of the appropriate deductions and exemptions. For the purposes of such tax he is engaged in trade or business within the United States but is not so engaged for the purposes of the application of the rate of 15 percent with respect to his dividends.

The United Kingdom does not impose its "standard" tax upon dividends but does impose surtax upon such dividends if the over-all income exceeds £2,000 or about $8,000. Paragraph 2 of article VI exempts from United Kingdom surtax dividends derived from United

Kingdom sources by residents of the United States. A citizen of the United States residing in Brazil is not, however, entitled to such exemption. Likewise, reduction in the rate of United States tax to 15 percent applies only to residents of the United Kingdom and does not apply to British subjects residing outside the United Kingdom.

The proviso found in paragraph (l) corresponds to and is applied subject to the same conditions substantially as is that found in article XI–2 of the Canadian convention.

The exchange of information at the source which naturally flows from reduction in the rate of tax or exemption from tax will be dealt with under article IX below.

ARTICLE VII

This article exempts upon a reciprocal basis interest flowing from United States sources to residents of the United Kingdom. The individuals in the United Kingdom entitled to such exemption are identical as to classification with those entitled to the 15-percent rate in the case of dividends, namely, nonresident aliens resident in the United Kingdom and nonresident in the United States; and foreign corporations controlled or managed in the United Kingdom. It will be observed that the article does not, in terms, refer to interest on United States obligations nor to United Kingdom Government securities, but merely refers to interest from sources within the respective countries. Interest on United States Government securities is, of course, interest from sources within the United States (sec. 119 (a) (1), Internal Revenue Code). The article contains an exception to the general rule, the effect of which exception is to deny exemption in the case of interest paid by a subsidiary corporation in one country to its parent corporation in the other. The exception has the desirable effect of eliminating the possibility of the parent taking the profits of the subsidiary in the nominal form of interest and thus avoiding tax on the subsidiary by the country in which it is situated.

ARTICLE VIII

This article exempts upon a reciprocal basis royalties and the like from United States sources flowing to the United Kingdom. The classification of individuals and corporations entitled to such exemption is identical with the classification of those persons entitled to the reduced rate of tax on dividends and to the exemption with respect to interest. The inclusion of film rentals within the scope of the term "royalties" is solely for the purposes of article VIII and does not disturb the essential nature of film rentals.

Under the British practice neither yearly interest nor royalties can be taken as deductions by the payor of such items in the computation of the payor's United Kingdom tax. Thus the payor pays the tax in the first instance to the Crown. However, when the interest or the royalty is disbursed the tax thus paid to the Crown is withheld from the gross amount of the interest or the royalty at the current rates of United Kingdom tax. Thus, if the gross amount of the receipt is $1,000 there is actually paid to the holder of the patent only $500, the remaining $500 being withheld by the payor to reimburse him for the tax previously paid to the Crown. In keeping with the principle of *Biddle* v. *Commissioner*, supra, the recipient includes $500 in his gross income for United States tax purposes and, of course,

no credit is allowed with respect to the $500 tax withheld at the source. *Irving Air Chute Co., Inc.* v. *Commissioner* (1 T. C. 880, affirmed 1/43 Fed. 2d (d) 266 certiorari denied). In the proposed convention no withholding will take place in the United Kingdom hence there will be included in gross income under the assumed facts the amount of $1,000. No credits will be involved since there is no United Kingdom tax imposed upon such item. Articles VII and VIII, therefore, while producing a decrease in the revenue through exemption from tax on items of interest and royalties going to a resident of the United Kingdom also tend to increase the revenue by reason of exemption from United Kingdom tax on such items flowing to the United States from the United Kingdom.

ARTICLE IX

Mineral royalties and real property rentals are subject to United Kingdom tax at the standard rate of 50 percent, not however upon the gross amount thereof but upon what is substantially net income from that source. Thus the taxpayer is subject to tax upon his net rentals arising from real property and shown in schedule A of the British Income Tax Act. The reduction in our rate from 30 to 15 percent upon the gross amount of the rentals is intended to constitute a tax burden corresponding as nearly as may be to the British rate of 50 percent upon the net rentals. Under the article, however, the nonresident alien resident in the United Kingdom and the foreign corporation controlled in the United Kingdom may elect as to any taxable year to be subject to United States tax as though he or it were engaged in trade or business within the United States in such taxable year, thus permitting deductions and credits against the gross rentals.

Paragraph 2 exempts from the United Kingdom surtax the items forming the subject matter of the article.

ARTICLE X

This article, corresponding in subject matter to article VI of the Canadian, to article X of the Swedish, and to article 8 of the French convention deals with the exemption from tax imposed by one of the contracting parties of salaries and the like paid by the other contracting party to individuals other than citizens of the former state. Thus the article is in substantial harmony with section 116 of the Internal Revenue Code. The article has, however, a feature not found in any other convention to which the United States is a party. Under United Kingdom law a United States citizen (female) marrying a British subject becomes ipso facto a British subject. As such, she is subject to tax by the United Kingdom if resident therein as are other British subjects and hence is subject to tax on income from sources in the United Kingdom. Thus, if such United States citizen while retaining her United States citizenship is employed in the American Embassy in London, the United Kingdom has heretofore asserted its right to tax such individual on her compensation for such services, but under the proposed convention the United Kingdom exempts such individual from United Kingdom tax upon her salary and the like as an employee of the United States. Reciprocally, the United States will not subject to its tax salaries and other compensation for services rendered the United Kingdom by a United States citizen who is also a British subject under the circumstances set forth above.

ARTICLE XI

This article corresponds to article VII of the Canadian and to article XI of the Swedish convention. The article provides upon a reciprocal basis for the exemption from United States tax of a resident of the United Kingdom upon his earned income from United States sources if--

(*a*) he is present in the United States for a period or periods aggregating not more than 183 days during the taxable year; and

(*b*) such income is paid by a United Kingdom employer.

No limitation is placed upon the amount of compensation for such services. It has no application to the remuneration of public entertainers such as actors, musicians, and athletes.

ARTICLE XII

This article exempts upon a reciprocal basis nongovernmental pensions and life annuities derived from sources within one country by a resident of the other. Through the definition "resident of the United Kingdom" it leaves untouched taxation of United States citizens. It covers only a minute segment of income.

ARTICLE XIII

In this article the United Kingdom adopts, with respect to United States income and excess-profits taxes, the system of credit for foreign income tax found in section 131 of the Internal Revenue Code. The credit provided in this article is, of course, one limited to the scope of section 131 and hence does not extend to the tax, if any, under section 102 or under section 500. The second sentence of paragraph (1), in effect, revokes the principle of *Biddle* v. *Commissioner*, supra. Thus in unusual instances a deduction may be allowed a British corporation for British tax while a credit will be allowed the United States shareholder of such corporation for portion of the same tax. However, it should be observed that the credit in such case is largely neutralized by reason of the inclusion in gross income of the amount of the British tax. It will also be seen that section 131 (f), Internal Revenue Code, allows a credit to the domestic parent corporation for its foreign subsidiary's foreign tax but does not require the inclusion of such foreign tax in the gross income of the parent. The foreign subsidiary may also be doing business in the United States, thus getting a deduction for a proportionate part of such foreign subsidiary's foreign tax.

Paragraph (3) of the article appears to merit some further consideration here. The adoption of the credit provisions by the United Kingdom will require allowance of the credit by the United Kingdom in cases in which individuals will be classed as residents of the United Kingdom by reason of the fact that such individuals sojourned in the United Kingdom for more than 6 months within the year of assessment. Thus, in example I, an engineer or other technician and a citizen of the United States is employed by a British concern at a salary of $18,000 per year. He spends 8 months of the year in England and the remaining 4 months in the United States. The

United Kingdom will subject him to tax upon his entire income. However, in the application of the credit, the United Kingdom will recognize that one-third of his earned income for such year has been derived from sources within the United States. Assume, however, in example II that he is employed by a United States domestic corporation and spends the same period of time in the United Kingdom. In this instance the United Kingdom would tax him only upon the amount of his income which he brings into the United Kingdom. In case I, the United Kingdom tax extends to the entire income, while the United States would in the converse situation tax only the salary allocable to the 8 months spent in the United States. In case II, however, the United States law would impose its tax upon the $12,000 regardless of whether such income was brought into the United States while the United Kingdom imposes its tax only if, and to the extent, the earned income is brought by the taxpayer into the United Kingdom.

On the other hand, if a British-controlled corporation pays director's fees to a United States citizen and resident such fees are subject to United Kingdom tax even though the recipient never was present in the United Kingdom. Again, the rules of taxation employed by the United Kingdom as between those (*a*) resident in the United Kingdom, (*b*) ordinarily resident in the United Kingdom, (*c*) domiciled in the United Kingdom are so complex that it is difficult, if not impossible to make a comparison between that system and the United States taxation of nonresident aliens. Because of such multiplicity of laws, the United Kingdom was disinclined to say that for all purposes earned income derived from sources within the United Kingdom by the residents of the United States would be subject to tax only with respect to such income attributed to services actually rendered in the United Kingdom. For the purposes of the credit, the United Kingdom will recognize such principles found in section 119 (a) (3) of the Internal Revenue Code.

ARTICLE XIV

This article corresponds to article VIII of the Canadian, article IX of the Swedish, and article 11 of the French convention. The rendition of personal services within the United States by a resident of the United Kingdom will not prevent the exemption from tax on capital gains even though such resident is thus engaged in trade or business within the United States.

The United Kingdom does not include capital gains within the tax base, unless the individual, corporation, or other entity, is a "trader" and registered as such, then such individual, corporation, or other entity, whether or not resident in the United Kingdom, is never subject to tax with respect to capital gains. The number of transactions has nothing to do with the liability. For example, a retired businessman may be actively engaged in stock-market transactions in his private capacity and not as a "trader" but he is not considered because of that fact liable to tax upon his gains. On the other hand the gain from a single securities sale by a bank is treated as trading profits of the bank and taxed as such. It is because of this factor that it was found impracticable to make the article reciprocal on its face even though it is so in fact.

ARTICLES XV, XVI, AND XVII

These articles correspond, respectively, to articles XII, XIII, and XIV of the Canadian convention. Under section 119 (a) (1) (B) and section 119 (a) (2) (B), Internal Revenue Code, interest and dividends paid by a foreign corporation constitute, provided the conditions laid down are met, income from sources within the United States and hence are subject to United States tax in the hands of residents of the United Kingdom. In practice it is recognized that only in rare instances is it practicable for the Bureau to ascertain whether a British corporation derives more than the requisite percentage of its gross income from United States sources so as to constitute its interest or its dividends income from sources within the United States. The situation is, therefore, highly theoretical and hence the article cannot be regarded as having any effect in terms of revenue, other than in those instances in which there is encountered a United Kingdom subsidiary corporation carrying on practically all its activities, and having its fiscal offices, in the United States.

Article XVI provides that a corporation organized under the laws of the United Kingdom shall not be subject to the tax imposed by (a) section 102 and (b) section 500 of the Internal Revenue Code if such corporation is controlled directly or indirectly by alien residents of the United Kingdom. Hence the article cannot be employed by United States citizens or residents in an effort to avoid the imposition of surtax. Thus, if two United States citizens undertake to create a United Kingdom corporation to avoid surtax, it is apparent from the text of the article that they must first surrender control over their capital into the hands of alien residents of the United Kingdom. It is suggested that, as reasonable men, they will not do so in order to avoid tax upon income arising from such capital.

In addition, United Kingdom law provides for the imposition of surtax on companies under the control of not more than five persons, such provisions being akin to section 500 in its terms and objectives—section 22, Finance Act of 1921, as amended by various subsequent finance acts. Under such provisions a reasonable part of the income of the company is deemed to have been distributed and thus is subject to surtax in the hands of the shareholders.

Article XVII corresponds to article XIV of the Canadian convention and has for its purposes the solution of problems growing out of provisions of our internal revenue laws existing prior to 1936 in accordance with which the great majority of nonresident aliens and foreign corporations deriving income from United States sources were subject to tax upon gains derived from transactions upon United States security and commodity exchanges. In practice, owing to factors beyond our control, it was found extremely difficult, if not impossible, to ascertain the identity of such aliens and, consequently, the tax was not as a practical matter enforceable. Beginning with the Revenue Act of 1936 such aliens were generally not subject to tax upon such gain but only taxable upon investment income and the like from United States sources. However, there remained a number of unsettled cases pending before the Commissioner concerning tax liability

for years prior to 1936. While it is believed that few cases involving British residents and corporations are outstanding, the British delegation considered it essential, in principle, that there be inserted in the proposed convention an article corresponding to that found in the Canadian convention and relating to the pre-1936 problem.

ARTICLE XVIII

This article finds no counterpart in any previous tax convention to which the United States is a party. Its effect is to exempt from United States tax, upon a reciprocal basis, compensation for personal services rendered in the United States by a resident of the United Kingdom who is temporarily present in the United States for the purpose of teaching at a United States university or other educational institution in the United States. The intent is to allow an exemption for 2 years in any event. Thus, if the individual comes to the United States under circumstances which indicate a stay within the United States in excess of 2 years, the exemption will apply in such case for the first 2 years. Such instances will, it is anticipated, be rare. It is the purpose of the article that such exemption shall cease at the end of 2 years from the date of his initial arrival in the United States. Thus, if he reaches the United States on July 1, 1945, he is exempt with respect to his remuneration earned in the United States up to June 30, 1947. If he then leaves the United States on vacation but resumes his duties in the United States at the beginning of the school term in the fall of 1947, he is not exempt with respect to his remuneration earned thereafter. If, however, he leaves the United States for an entire year or more and then returns to the United States, it is the intendment of the article that he will then enter upon another exemption period of 2 years. In the normal case, however, the article will be concerned with a situation in which the exchange professor will be present in the United States only during the period covered by one academic year.

ARTICLE XIX

This article corresponds to article IX of the Canadian, to article XII of the Swedish, and to article 12 of the French convention. From the United States standpoint it has little or no practical effect since the amounts involved are not ordinarily gross income in any event in the hands of the recipients thereof.

ARTICLE XX

This article corresponds to articles XIX, XX, and XXI of the Canadian convention, to articles XV, XVI, XVIII, and XIX of the Swedish convention and to articles 20, 21, and 22 of the French convention. While the terms of article XX are quite general, it is the intendment of such article to exchange such information upon a broad scale between the revenue authorities of the two countries both with respect to periodic information covering recurring income and also as to specific cases. The problems arising in this general field are akin to those encountered in the administration of our existing

tax conventions, especially that with Canada. The details of the regulatory measures necessary to implement the convention in this regard will be formulated, as was done in the case of Canada, after consultations between the two revenue services with a view toward bringing the terms of the convention into effect as early as practicable and at the same time safeguard the interests of the revenue.

ARTICLE XXI

This article is in principle identical with paragraph 12 of the protocol to the Canadian convention, paragraph 7 of the protocol to the Swedish convention, and to paragraph V of the protocol to the French convention. It is, however, more elaborately drawn in order to bring within its scope British subjects residing in areas to which the convention is applicable and United States citizens residing in areas to which the convention is applicable and extension to juridical persons. It will be observed that this article extends to all taxes, both Federal and local. Such extension, however, is in keeping with several commercial treaties (such as that with Norway, of 1928, and that with Germany, of 1923) to which the United States is now a party. It has no practical effect, since our domestic taxation does not discriminate as between United States citizens and British nationals residing in the United States.

ARTICLE XXII

This article finds no counterpart in any convention to which the United States is now a party. Its basic purpose is to make possible extension of the convention to colonies, overseas territories, or other areas over which one of the countries exercises authority. Each country has reserved veto power over applications for extensions made by the other country. The article has no application to sovereign members of the British Commonwealth of Nations, such as Canada, Australia, and New Zealand.

ARTICLE XXIII

This article provides that the convention comes into effect with the calendar year 1945, as to United States tax, and on the 6th of April 1945, for the purposes of United Kingdom tax, thus bringing the convention into effect coincident in the respective countries with the commencement of new taxable years. However, in the case of the United Kingdom, the surtax is a year behind the income tax. Thus, the surtax for the year of assessment 1944–45 is based on the income for the year ended April 5, 1945, and is payable on or before January 1, 1946. The excess-profits tax and national defense contribution follow conventional accounting periods and not the historical dates associated with the income tax and surtax. Since the convention is retroactive to January 1, 1945, it is anticipated that the initial effects of the convention from the United States standpoint will be to release excess taxes withheld by withholding agents in the United States as was done in the case of Canada (see T. D. 5157, C. B. 1942–2, 137).

ARTICLE XXIV

This article provides the usual conditions under which the convention may be terminated and specifies the dates upon which the convention shall cease to be effective, the dates thus stated being such as will allow the convention to be in effect in one country for the same length of time as in the other.

MESSAGE FROM THE PRESIDENT OF THE UNITED STATES, TRANSMITTING A CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND, FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME, SIGNED AT WASHINGTON ON APRIL 16, 1945

THE WHITE HOUSE, *April 24, 1945.*

To the Senate of the United States:

With a view to receiving the advice and consent of the Senate to ratification, I transmit herewith two conventions between the United States of America and the United Kingdom of Great Britain and Northern Ireland, which were signed in Washington on April 16, 1945, as follows: (1) A convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, and (2) a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on the estates of deceased persons.

The conventions have the approval of the Department of State and the Treasury Department.

I also transmit herewith, for the information of the Senate, the report of the Secretary of State with respect to the conventions.

HARRY S. TRUMAN.

(Enclosures: (1) Report of the Secretary of State; (2) convention between the United States and the United Kingdom, signed April 16, 1945, relating to taxes on income; (3) convention between the United States and the United Kingdom, signed April 16, 1945, relating to taxes on the estates of deceased persons.)

DEPARTMENT OF STATE,
Washington, April 16, 1945.

The PRESIDENT,
The White House:

The undersigned, the Secretary of State, has the honor to lay before the President, with a view to their transmission to the Senate to receive the advice and consent of that body to ratification, if his judgment approve thereof, two conventions between the United States of America and the United Kingdom of Great Britain and Northern Ireland, which were signed in Washington on April 16, 1945, as follows: (1) A convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, and (2) a convention

for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on the estates of deceased persons.

The Department of State and the Treasury Department collaborated in the negotiation of the conventions. The conventions have the approval of both Departments.

Realizing that the imposition and collection of taxes upon the same income or upon the same estate by both the United States of America and the United Kingdom may, and often do, result in double taxation of a severe character, representatives of this Government have engaged in technical discussions with representatives of the British Government with a view to determining the bases upon which conventions between the two Governments might be concluded for the purpose of avoiding double taxation, insofar as practicable, modifying certain conflicting principles of taxation for this purpose and establishing certain procedures for the exchange of information between the two countries in relation to taxation. The two conventions submitted herewith were formulated as a result of those discussions.

In matters of principle and substance, most of the provisions of the convention relating to taxes on income are consistent, if not identical, with provisions in one or another of the existing income-tax conventions between the United States of America and certain foreign countries, namely, (1) the convention and protocol of March 23, 1939, with Sweden, which became effective on January 1, 1940; (2) the convention and protocol of March 4, 1942, with Canada, which was made effective as of January 1, 1941; and (3) the convention and protocol of July 25, 1939, with France, which became effective on January 1, 1945.

The convention relating to taxes on the estates of deceased persons is similar, in substantial respects, to the existing convention of June 8, 1944, between the United States of America and Canada, relating to double taxation in the case of estate taxes and succession duties, which, upon the exchange of instruments of ratification, became effective as of June 14, 1941.

It is believed that the application of the provisions of an income-tax convention of the kind submitted herewith will constitute a definite step toward the removal of an undesirable impediment to international trade which results from the double taxation of incomes, and that the application of the provisions of an estate-tax convention of the kind submitted herewith will go far toward eliminating double taxation in connection with the settlement in either country of estates in which nationals of the other country have interests. The two conventions establish a satisfactory basis for the ultimate accomplishment of objectives in the mutual interest of the two countries.

Considering each of the two conventions separately, statements in further explanation are made in the paragraphs below.

CONVENTION RELATING TO TAXES ON INCOME

The major features of the income-tax convention may be summarized as follows:

(1) Specific reference to the taxes to which the convention relates and extensive definition of terms found in the convention (arts. I and II).

(2) Adoption of principles affecting the determination of amount, and affecting the taxation, of business income derived by business enterprises of one country from sources within the other country (arts. III, IV, and V).

(3) Reduction in the United States rate of tax at the source from 30 to 15 percent in the case of dividends moving from the United States to the United Kingdom and, correspondingly, continuance of the existing British system of exemption from income tax, and adoption of exemption from United Kingdom surtax, in the case of dividends moving from the United Kingdom to the United States (art. VI).

(4) Exemption from taxation of (*a*) interest, (*b*) royalties, (*c*) Government salaries, (*d*) annuities and pensions, and (*e*) earned income derived from sources in one country by residents or corporations of the other country not engaged in trade or business in the former country (arts. VII, VIII, IX, X, XI, and XII).

(5) Continuation and expansion by the United States of the credit for foreign income taxes, and adoption by the United Kingdom of the principle of credit for United States income tax (art. XIII).

(6) Alleviation, with respect to residents of the United Kingdom, of taxation by the United States of nonresident aliens and foreign corporations in the case of certain taxes alleged to have an extraterritorial character (arts. XIV, XV, and XVI).

(7) Settlement of pending cases affecting residents of the United Kingdom or United Kingdom corporations and involving the taxation of capital gains and the application of principles to which (6), above, relates (art. XVII).

(8) Exemption, upon certain conditions, of professors or teachers and students or business apprentices from taxes on their remuneration or on payments made to them (arts. XVIII and XIX).

(9) Cooperation between the contracting countries with a view to the prevention of evasion of taxation imposed by the respective countries (art. XX).

(10) Extension of the principle, expressed in many treaties of the United States, respecting national treatment of resident aliens in tax matters with a view to equality of taxation (art. XXI).

(11) Laying the ground work for application of the provisions of the convention to colonies or other territories which impose taxes substantially similar to the taxes to which the convention relates (art. XXII).

Some of the significant provisions of the convention may be explained further as follows, particularly with a view to indicating the extent to which the convention may modify the existing revenue laws of the United States:

By article I, the convention is made applicable, in respect of the United States, only to Federal income taxes, including surtaxes and excess-profits taxes. Consequently, the convention does not apply to taxes imposed by the several States of the United States, with one exception, namely, article XXI, to which further reference is made hereinafter.

By article VI the 30-percent rate of United States tax generally applied with respect to nonresident aliens and nonresident foreign corporations, and the higher rates of normal tax and surtax when applicable to such aliens, are reduced to 15 percent in the case of

dividends in general, or to 5 percent in the case of dividends paid by a United States domestic subsidiary corporation to its British parent corporation. A like reduction to 15 percent is applied, under article IX, to gross mineral royalties and to gross real-property rentals derived from United States sources by residents of the United Kingdom, such reduced rate being considered substantially equivalent to the rate of 50 percent upon net rentals flowing from the United Kingdom to the United States. The United Kingdom, in effect, imposes no tax on dividends as such, but does impose surtax with respect to dividends; under the proposed convention dividends moving to the United States from the United Kingdom will thus be exempt from United Kingdom standard tax and surtax.

By articles VII and VIII interest and royalties are wholly exempt upon a reciprocal basis. Accordingly, interest and royalties will move to the United States from the United Kingdom free from United Kingdom tax (otherwise generally imposed at the rate of 50 percent) and from the United States to the United Kingdom free from United States tax (otherwise generally imposed at the rate of 30 percent).

By article XI the United States agrees to continue, during the lifetime of the convention, its existing system of credit for foreign tax insofar as credit for United Kingdom income tax is concerned, and to liberalize such system so as to allow credit for United Kingdom tax on earnings out of which dividends are paid to United States shareholders of United Kingdom corporations. The United Kingdom, on the other hand, agrees to adopt the system of credit for United States tax imposed upon income derived from United States sources by residents of the United Kingdom or by United Kingdom corporations.

It has long been a provision of United States revenue laws that, upon certain conditions, dividends paid by a foreign corporation to nonresident aliens or foreign corporations are to be regarded as income from sources within the United States and, as such, taxable by the United States even though the recipient of such dividends and the foreign corporation paying them are not resident in the United States. The United Kingdom law does not contain any corresponding provision. That provision of the United States revenue laws has been the object of frequent objections, it being charged that such a provision has an extraterritorial character. The existing income-tax convention with Canada makes that provision inapplicable to residents of Canada. Article XV of the convention with the United Kingdom makes the provision inapplicable to residents of the United Kingdom.

Similarly, article XVI makes the personal-holding-company provisions of the United States revenue laws inapplicable to United Kingdom corporations which are controlled by residents of the United Kingdom. In this respect article XVI is identical in principle with article XIII of the income-tax convention between the United States and Canada (S. Executive B, 77th Cong., 2d sess., contains a detailed statement concerning art. XIII of the convention with Canada), which makes the personal-holding-company provisions inapplicable to Canadian corporations. Article XVI of the convention with the United Kingdom contains safeguards against the exemption being used as a means of tax avoidance.

Article XVII is identical in principle with article XIV of the income-tax convention with Canada. Under article XIV of that convention

the settlement of cases involving Canadians and Canadian corporations with respect to taxable years beginning prior to 1936, and generally involving the taxation of capital gains from sources within the United States, has been facilitated. While the number of similar cases involving United Kingdom residents and United Kingdom corporations is believed to be small, it is considered desirable to extend to the United Kingdom the same provisions in this respect as are found in the existing convention with Canada.

Article XX marks an important step in the direction of fiscal cooperation between the United States and the United Kingdom in the field of income taxation. Under this article there will be obtained by the United States, upon a reciprocal basis, information with respect to income derived by residents of the United States from sources in the United Kingdom, as well as information in cases of specific taxpayers with respect to whom information is available to the revenue authorities of the United Kingdom. The principle here adopted materially complements the United States domestic system of information at the source and, it is anticipated, will be of considerable utility in the administration of United States revenue laws, even though the British system of information at source is less comprehensive than that employed by the United States.

Article XXI gives expression to principles, long recognized in practice in the United States and found in many commercial or general-relations treaties of the United States, relating to equality of taxation in the United States as between United States citizens residing in the United States and aliens resident in the United States. Article XXI effects no change in existing United States revenue laws.

Article XXII is an innovation so far as tax conventions of the United States are concerned. It lays the basis for application of the convention to colonies, overseas territories, and certain other areas over which authority is exercised by the respective Governments. It is anticipated that many of the British colonies or other territories, which have tax systems closely analogous to that existing in the United Kingdom, will elect, in the course of time, to come within the scope of the convention. This, it is expected, will have the effect of providing a solution to problems in the field of income taxation which may exist between the United States and such colonies or other territories, and of stimulating the economic ties between the United States and such areas. Inasmuch as the United States revenue laws do not extend to overseas Possessions, such as Puerto Rico, those Possessions will be free to elect to come within the scope of the convention, as they see fit.

Article XXIII provides for ratification and for the exchange of instruments of ratification and prescribes the effective dates of the convention. Under article XXIII the convention will become effective with respect to taxable years beginning on or after January 1, 1945, as to the United States, and, as to the United Kingdom, with respect to years of assessment beginning in accordance with the corresponding British tax system. It is provided in article XXIV that the convention shall continue in effect indefinitely, but may be terminated by the giving of a notice for that purpose by either Government to the other Government on or before June 30 in any year after 1946, so that as to the United States the convention may be terminated with respect to taxable years beginning on or after January 1, 1947,

and as to the United Kingdom the convention may be terminated with respect to years of assessment beginning on or after April 6, 1947. The provisions of article VI, relating to dividends, are made subject to termination, without affecting the remaining provisions of the convention, at the end of a 2-year period or thereafter by the giving of a notice along the lines of that prescribed in article XXIV.

CONVENTION RELATING TO TAXES ON ESTATES

The estate-tax convention with the United Kingdom, like the estate tax and succession duty convention of June 8, 1944, with Canada (S. Executive G, 78th Cong., 2d sess.), has for its principal purpose the elimination, insofar as practicable, of double taxation which otherwise would result from the application to the same estate of both Federal estate taxes and British estate duties. The convention also contains provisions relating to mutual administrative assistance through the exchange of information, with a view to discouraging tax evasion.

As in the case of the convention with Canada, the convention with the United Kingdom extends in its application, insofar as the United States is concerned, only to estate taxes imposed by the Federal Government. The imposition and collection of inheritance or estate taxes by States or Territories of the United States or by the District of Columbia are not restricted by the convention. As to the United Kingdom, the convention is applicable to the estate duty but does not apply to United Kingdom legacy or succession duties.

In the technical discussions which resulted in the formulation of the convention, consideration was given to the basic differences between the American and British systems of taxation affecting the settlement of estates. The two systems were found to be sufficiently comparable to make it possible for the taxing authorities of the two Governments to reach a satisfactory understanding with respect to a number of important matters of principle.

The provisions of the convention are contained in 11 articles. The following explanations of the provisions may be useful (the word "convention," unless otherwise indicated, is here used in reference to the convention with the United Kingdom):

Article I specifies the taxes to which the convention applies. This is analogous to article I of the convention of 1944 with Canada. The taxes are the Federal estate tax imposed by the United States and the United Kingdom estate duty imposed in Great Britain.

Article II contains definitions of terms found in the convention. It corresponds, in general, to article XIII of the convention of 1944 with Canada.

Article III contains rules, for the purposes of the operation of the convention, relating to the situs of rights and interests forming part of an estate to which the convention may be applicable. This article corresponds, in general, to articles II, III, and IV of the convention of 1944 with Canada. The treatment is considerably different in a number of respects, but the object is essentially the same in that the provisions are designed mainly to establish a greater degree of uniformity in administering the applicable revenue laws and to facilitate, upon a reasonable basis, the settlement of estates.

Articles IV, V, and VI contain fundamental provisions relating to the bases upon which estate taxes shall be computed and upon which relief from double taxation shall be accorded. The plan which would be made effective by these provisions is consistent with the principles expressed in existing tax conventions of the United States. The provisions in articles IV, V, and VI are analogous to, but in some respects simpler than, provisions in articles V and VI of the convention of 1944 with Canada.

Article VII contains provisions relating to the exchange of information, leading to administrative cooperation in preventing fiscal evasion. It corresponds to article VII of the convention of 1944 with Canada, except that paragraph (2) of article VII (containing certain definitions) of the convention with the United Kingdom is analogous to paragraph 1 of article XIII of the convention with Canada.

The provisions of article VIII do not correspond to any provisions of existing tax conventions of the United States. Like article XXII of the income-tax convention with the United Kingdom, it lays the basis for application of the convention to colonies, overseas territories, and certain other areas over which authority is exercised by the respective Governments. The statements which have been made hereinbefore concerning article XXII of the income-tax convention are applicable, in a general way, to article VIII of the estate-tax convention.

Article IX, which is to be considered in conjunction with article VIII, represents a formula proposed by the British authorities, in accordance with British constitutional procedure, with a view to making the convention applicable in respect of Northern Ireland.

Article X provides for ratification and prescribes that the convention shall come into force on the date of the exchange of instruments of ratification, to be effective only (1) as to estates of persons dying on or after that date, and (2) at the option of the personal representative, upon appropriate conditions, as to the estate of any person dying before that date and after December 31, 1944.

It is provided in article XI that the convention shall remain in force not less than 3 years, but may be terminated at the end of that 3-year period or at any time thereafter by the giving of a notice for that purpose by either Government to the other Government, the termination to be effective as to the estates of persons dying on or after the date specified in the notice, such date being not less than 60 days after the date of the notice, or, if no date of termination be specified, the termination is to be effective as to the estates of persons dying on or after the sixtieth day after the date of the notice.

The fundamental provisions of the convention may be summarized as follows:

(1) The uniform rules relating to the situs of property, as set forth in article III. The determination of situs with respect to certain types of property is necessary for the purposes of the convention, first, in order to ascertain the property that may be included for tax computation if jurisdiction be based on situs of property within the country, and, second, in order to ascertain the credit for estate taxes attributable to property situated as prescribed in the credit article. For example, a simple rule for the determination of the situs of shares of corporate stock is provided, namely, that the situs shall be where the issuing corporation was created or organized. This uniform rule

is adopted by the United Kingdom in place of a complexity of rules now applicable in such cases. This uniform rule is one of long standing in the United States, but under the convention the United States relinquishes another and inconsistent rule, namely, that the situs of corporate stock is where the stock certificate is located.

(2) The credit provisions, as set forth in article V, whereby the country of the decedent's domicile, or the country of the decedent's citizenship in the case of the United States, allows a credit against its tax for the tax paid the other country with respect to property which otherwise would be subjected to taxation by both countries. The credit authorized by the convention is subordinated to and has no effect upon the credit against the Federal estate tax authorized by section 813 (b) of the Internal Revenue Code for inheritance and estate taxes paid to the States, Territories, or possessions of the United States, or to the District of Columbia.

Respectfully submitted.

E. R. STETTINIUS, Jr.

(Enclosures: (1) Convention between the United States and the United Kingdom, signed April 16, 1945, relating to taxes on income; (2) convention between the United States and the United Kingdom, signed April 16, 1945, relating to taxes on the estates of deceased persons.)

CONVENTION WITH GREAT BRITAIN AND NORTHERN IRELAND WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland,

Desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income,

Have appointed for that purpose as their Plenipotentiaries:

The Government of the United States of America:

Mr. Edward R. Stettinius, Jr., Secretary of State, and

The Government of the United Kingdom of Great Britain and Northern Ireland:

The Right Honorable the Earl of Halifax, K. G., Ambassador Extraordinary and Plenipotentiary in Washington,

Who, having exhibited their respective full powers, found in good and due form, have agreed as follows:

ARTICLE I

(1) The taxes which are the subject of the present Convention are:

(a) In the United States of America: The Federal income taxes, including surtaxes and excess profits taxes (hereinafter referred to as United States tax).

(b) In the United Kingdom of Great Britain and Northern Ireland: The income tax (including surtax), the excess profits tax and the national defense contribution (hereinafter referred to as United Kingdom tax).

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Party

subsequently to the date of signature of the present Convention or by the government of any territory to which the present Convention is extended under Article XXII.

ARTICLE II

(1) In the present Convention, unless the context otherwise requires:

(a) The term "United States" means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and of Hawaii, and the District of Columbia.

(b) The term "United Kingdom" means Great Britain and Northern Ireland, excluding the Channel Islands and the Isle of Man.

(c) The terms "territory of one of the Contracting Parties" and "territory of the other Contracting Party" mean the United States or the United Kingdom as the context requires.

(d) The term "United States corporation" means a corporation, association or other like entity created or organized in or under the laws of the United States.

(e) The term "United Kingdom corporation" means any kind of juridical person created under the laws of the United Kingdom.

(f) The terms "corporation of one Contracting Party" and "corporation of the other Contracting Party" means a United States corporation or a United Kingdom corporation as the context requires.

(g) The term "resident of the United Kingdom" means any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States tax. A corporation is to be regarded as resident in the United Kingdom if its business is managed and controlled in the United Kingdom.

(h) The term "resident of the United States" means any individual who is resident in the United States for the purposes of United States tax and not resident in the United Kingdom for the purposes of United Kingdom tax, and any United States corporation and any partnership created or organized in or under the laws of the United States, being a corporation or partnership which is not resident in the United Kingdom for the purposes of United Kingdom tax.

(i) The term "United Kingdom enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United Kingdom.

(j) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United States.

(k) The terms "enterprise of one of the Contracting Parties" and "enterprise of the other Contracting Party" mean a United States enterprise or a United Kingdom enterprise, as the context requires.

(l) The term "permanent establishment" when used with respect to an enterprise of one of the Contracting Parties means a branch, management, factory or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the Contracting Parties shall not be deemed to have a permanent establishment in the territory of the other Contracting Party merely because it carries on business dealings in the territory of such other Contracting Party through a *bona fide* commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting Parties maintains in the territory of the other Contracting Party a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one Contracting Party has a subsidiary corporation which is a corporation of the other Contracting Party or which is engaged in trade or business in the territory of such other Contracting Party (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

(2) For the purposes of Articles VI, VII, VIII, IX and XIV a resident of the United Kingdom shall not be deemed to be engaged in trade or business in the United States in any taxable year unless such resident has a permanent establishment situated therein in such taxable year. The same principle shall be applied, *mutatis mutandis*, by the United Kingdom in the case of a resident of the United States.

(3) In the application of the provisions of the present Convention by one of the Contracting Parties any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting Party relating to the taxes which are the subject of the present Convention.

Article III

(1) A United Kingdom enterprise shall not be subject to United States tax in respect of its industrial or commercial profits unless it is engaged in trade or business in the United States through a permanent establishment situated therein. If it is so engaged, United States tax may be imposed upon the entire income of such enterprise from sources within the United States.

(2) A United States enterprise shall not be subject to United Kingdom tax in respect of its industrial or commercial profits unless is is engaged in trade or business in the United Kingdom through a permanent establishment situated therein. If it is so engaged, United Kingdom tax may be imposed upon the entire income of such enterprise from sources within the United Kingdom: Provided that nothing in this paragraph shall affect any provisions of the law of the United Kingdom regarding the imposition of United Kingdom excess

profits tax and national defence contribution in the case of interconnected companies.

(3) Where an enterprise of one of the Contracting Parties is engaged in trade or business in the territory of the other Contracting Party through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment, and the profits so attributed shall, subject to the law of such other Contracting Party, be deemed to be income from sources within the territory of such other Contracting Party.

(4) In determining the industrial or commercial profits from sources within the territory of one of the Contracting Parties of an enterprise of the other Contracting Party, no profits shall be deemed to arise from the mere purchase of goods or merchandise within the territory of the former Contracting Party by such enterprise.

ARTICLE IV

Where an enterprise of one of the Contracting Parties, by reason of its participation in the management, control or capital of an enterprise of the other Contracting Party, makes with or imposes on the latter, in their commercial or financial relations, conditions different from those which would be made with an independent enterprise, any profits which would but for those conditions have accrued to one of the enterprises but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

ARTICLE V

(1) Notwithstanding the provisions of Articles III and IV of the present Convention, profits which an individual (other than a citizen of the United States) resident in the United Kingdom or a United Kingdom corporation derives from operating ships documented or aircraft registered under the laws of the United Kingdom, shall be exempt from United States tax.

(2) Notwithstanding the provisions of Articles III and IV of the present Convention, profits which a citizen of the United States not resident in the United Kingdom or a United States corporation derives from operating ships documented or aircraft registered under the laws of the United States, shall be exempt from United Kingdom tax.

(3) This Article shall be deemed to have superseded, on and after the first day of January, 1945, as to United States tax, and on and after the 6th day of April, 1945, as to United Kingdom tax, the arrangements relating to reciprocal exemption of shipping profits from income tax effected between the Government of the United States and the Government of the United Kingdom by exchange of Notes dated August 11, 1924, November 18, 1924, November 26, 1924, January 15, 1925, February 13, 1925 and March 16, 1925, which shall accordingly cease to have effect.

ARTICLE VI

(1) The rate of United States tax on dividends derived from a United States corporation by a resident of the United Kingdom who is subject to United Kingdom tax on such dividends and not engaged in trade or business in the United States shall not exceed 15 percent: Provided that such rate of tax shall not exceed five percent if such resident is a corporation controlling, directly or indirectly, at least 95 percent of the entire voting power in the corporation paying the dividend, and not more than 25 percent of the gross income of such paying corporation is derived from interest and dividends, other than interest and dividends received from its own subsidiary corporations. Such reduction of the rate to five percent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate.

(2) Dividends derived from sources within the United Kingdom by an individual who is (a) a resident of the United States, (b) subject to United States tax with respect to such dividends, and (c) not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom surtax.

(3) Either of the Contracting Parties may terminate this Article by giving written notice of termination to the other Contracting Party, through diplomatic channels, on or before the thirtieth day of June in any year after the year 1945, and in such event paragraph (1) hereof shall cease to be effective as to United States tax on and after the first day of January, and paragraph (2) hereof shall cease to be effective as to United Kingdom tax on and after the 6th day of April, in the year next following that in which such notice is given.

ARTICLE VII

(1) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) derived from sources within the United States by a resident of the United Kingdom who is subject to United Kingdom tax on such interest and not engaged in trade or business in the United States, shall be exempt from United States tax; but such exemption shall not apply to such interest paid by a United States corporation to a corporation resident in the United Kingdom controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

(2) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) derived from sources within the United Kingdom by a resident of the United States who is subject to United States tax on such interest and not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom tax; but such exemption shall not apply to such interest paid by a corporation resident in the United Kingdom to a United States corporation controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

ARTICLE VIII

(1) Royalties and other amounts paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulae, trade-marks, and other like property, and

derived from sources within the United States by a resident of the United Kingdom who is subject to United Kingdom tax on such royalties or other amounts and not engaged in trade or business in the United States, shall be exempt from United States tax.

(2) Royalties and other amounts paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulae, trade-marks, and other like property, and derived from sources within the United Kingdom by a resident of the United States who is subject to United States tax on such royalties or other amounts and not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom tax.

(3) For the purposes of this Article the term "royalties" shall be deemed to include rentals in respect of motion picture films.

ARTICLE IX

(1) The rate of United States tax on royalties in respect of the operation of mines or quarries or of other extraction of natural resources, and on rentals from real property or from an interest in such property, derived from sources within the United States by a resident of the United Kingdom who is subject to United Kingdom tax with respect to such royalties or rentals and not engaged in trade or business in the United States, shall not exceed 15 percent: Provided that any such resident may elect for any taxable year to be subject to United States tax as if such resident were engaged in trade or business in the United States.

(2) Royalties in respect of the operation of mines or quarries or of other extraction of natural resources, and rentals from real property or from an interest in such property, derived from sources within the United Kingdom by an individual who is (a) a resident of the United States, (b) subject to United States tax with respect to such royalties and rentals, and (c) not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom surtax.

ARTICLE X

(1) Any salary, wage, similar remuneration, or pension, paid by the Government of the United States to an individual (other than a British subject who is not also a citizen of the United States) in respect of services rendered to the United States in the discharge of governmental functions, shall be exempt from United Kingdom tax.

(2) Any salary, wage, similar remuneration, or pension, paid by the Government of the United Kingdom to an individual (other than a citizen of the United States who is not also a British subject) in respect of services rendered to the United Kingdom in the discharge of governmental functions, shall be exempt from United States tax.

(3) The provisions of this Article shall not apply to payments in respect of services rendered in connection with any trade or business carried on by either of the Contracting Parties for purposes of profit.

ARTICLE XI

(1) An individual who is a resident of the United Kingdom shall be exempt from United States tax upon compensation for personal (including professional) services performed during the taxable year

within the United States if (a) he is present within the United States for a period or periods not exceeding in the aggregate 183 days during such taxable year, and (b) such services are performed for or on behalf of a person resident in the United Kingdom.

(2) An individual who is a resident of the United States shall be exempt from United Kingdom tax upon profits, emoluments or other remuneration in respect of personal (including professional) services performed within the United Kingdom in any year of assessment if (a) he is present within the United Kingdom for a period or periods not exceeding in the aggregate 183 days during that year, and (b) such services are performed for or on behalf of a person resident in the United States.

(3) The provisions of this Article shall not apply to the compensation, profits, emoluments or other remuneration of public entertainers such as stage, motion picture or radio artists, musicians and athletes.

ARTICLE XII

(1) Any pension (other than a pension to which Article X applies), and any life annuity, derived from sources within the United States by an individual who is a resident of the United Kingdom shall be exempt from United States tax.

(2) Any pension (other than a pension to which Article X applies), and any life annuity, derived from sources within the United Kingdom by an individual who is a resident of the United States shall be exempt from United Kingdom tax.

(3) The term "life annuity" means a stated sum payable periodically at stated times, during life or during a specified or ascertainable period of time, under an obligation to make the payments in consideration of money paid.

ARTICLE XIII

(1) Subject to section 131 of the United States Internal Revenue Code as in effect on the first day of January, 1945, United Kingdom tax shall be allowed as a credit against United States tax. For this purpose, the recipient of a dividend paid by a corporation which is a resident of the United Kingdom shall be deemed to have paid the United Kingdom income tax appropriate to such dividend if such recipient elects to include in his gross income for the purposes of United States tax the amount of such United Kingdom income tax.

(2) Subject to such provisions (which shall not affect the general principle hereof) as may be enacted in the United Kingdom, United States tax payable in respect of income from sources within the United States shall be allowed as a credit against any United Kingdom tax payable in respect of that income. Where such income is an ordinary dividend paid by a United States corporation, such credit shall take into account (in addition to any United States income tax deducted from or imposed on such dividend) the United States income tax imposed on such corporation in respect of its profits, and where it is a dividend paid on participating preference shares and representing both a dividend at the fixed rate to which the shares are entitled and an additional participation in profits, such tax on profits shall likewise be taken into account in so far as the dividend exceeds such fixed rate.

(3) For the purposes of this Article, compensation, profits, emoluments and other remuneration for personal (including professional) services shall be deemed to be income from sources within the territory of the Contracting Party where such services are performed.

ARTICLE XIV

A resident of the United Kingdom not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets.

ARTICLE XV

Dividends and interest paid on or after the first day of January 1945 by a United Kingdom corporation shall be exempt from United States tax except where the recipient is a citizen of or a resident of the United States or a United States corporation.

ARTICLE XVI

A United Kingdom corporation shall be exempt from United States tax on its accumulated or undistributed earnings, profits, income or surplus, if individuals who are residents of the United Kingdom control, directly or indirectly, throughout the last half of the taxable year, more than 50 percent of the entire voting power in such corporation.

ARTICLE XVII

(1) The United States income tax liability for any taxable year beginning prior to January 1, 1936 of any individual (other than a citizen of the United States) resident in the United Kingdom, or of any United Kingdom corporation, remaining unpaid on the date of signature of the present Convention, may be adjusted on a basis satisfactory to the United States Commissioner of Internal Revenue: Provided that the amount to be paid in settlement of such liability shall not exceed the amount of the liability which would have been determined if

(a) the United States Revenue Act of 1936 (except in the case of a United Kingdom corporation in which more than 50 percent of the entire voting power was controlled, directly or indirectly, throughout the latter half of the taxable year, by citizens or residents of the United States), and

(b) Articles XV and XVI of the present Convention,

had been in effect for such year. If the taxpayer was not, within the meaning of such Revenue Act, engaged in trade or business in the United States and had no office or place of business therein during the taxable year, the amount of interest and penalties shall not exceed 50 percent of the amount of the tax with respect to which such interest and penalties have been computed.

(2) The United States income tax unpaid on the date of signature of the present Convention for any taxable year beginning after the thirty-first day of December 1935 and prior to the first day of January

1945 in the case of an individual (other than a citizen of the United States) resident of the United Kingdom, or in the case of any United Kingdom corporation shall be determined as if the provisions of Articles XV and XVI of the present Convention had been in effect for such taxable year.

(3) The provisions of paragraph (1) of this Article shall not apply—

(a) unless the taxpayer files with the Commissioner of Internal Revenue on or before the thirty-first day of December 1947 a request that such tax liability be so adjusted and furnishes such information as the Commissioner may require; or

(b) in any case in which the Commissioner is satisfied that any deficiency in tax is due to fraud with intent to evade the tax.

ARTICLE XVIII

A professor or teacher from the territory of one of the Contracting Parties who visits the territory of the other Contracting Party for the purpose of teaching, for a period not exceeding two years, at a university, college, school or other educational institution in the territory of such other Contracting Party shall be exempted by such other Contracting Party from tax on his remuneration for such teaching for such period.

ARTICLE XIX

A student or business apprentice from the territory of one of the Contracting Parties who is receiving full-time education or training in the territory of the other Contracting Party shall be exempted by such other Contracting Party from tax on payments made to him by persons within the territory of the former Contracting Party for the purposes of his maintenance, education or training.

ARTICLE XX

(1) The taxation authorities of the Contracting Parties shall exchange such information (being information available under the respective taxation laws of the Contracting Parties) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of the present Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than those concerned with the assessment and collection of the taxes which are the subject of the present Convention. No information shall be exchanged which would disclose any trade secret or trade process.

(2) As used in this Article, the term "taxation authorities" means, in the case of the United States, the Commissioner of Internal Revenue or his authorized representative; in the case of the United Kingdom, the Commissioners of Inland Revenue or their authorized representative; and, in the case of any territory to which the present Convention is extended under Article XXII, the competent authority for the administration in such territory of the taxes to which the present Convention applies.

ARTICLE XXI

(1) The nationals of one of the Contracting Parties shall not, while resident in the territory of the other Contracting Party, be subjected therein to other or more burdensome taxes than are the nationals of such other Contracting Party resident in its territory.

(2) The term "nationals" as used in this Article means

(a) in relation to the United Kingdom, all British subjects and British protected persons, from the United Kingdom or any territory with respect to which the present Convention is applicable by reason of extension made by the United Kingdom under Article XXII; and

(b) in relation to the United States, United States citizens, and all persons under the protection of the United States, from the United States or any territory to which the present Convention is applicable by reason of extension made by the United States under Article XXII;

and includes all legal persons, partnerships and associations deriving their status as such from, or created or organized under, the laws in force in any territory of the Contracting Parties to which the present Convention applies.

(3) In this Article the word "taxes" means taxes of every kind or description, whether national, Federal, state, provincial or municipal.

ARTICLE XXII

(1) Either of the Contracting Parties may, at the time of exchange of instruments of ratification or thereafter while the present Convention continues in force, by a written notification of extension given to the other Contracting Party through diplomatic channels, declare its desire that the operation of the present Convention shall extend to all or any of its colonies, overseas territories, protectorates, or territories in respect of which it exercises a mandate, which impose taxes substantially similar in character to those which are the subject of the present Convention. The present Convention shall apply to the territory or territories named in such notification on the date or dates specified in the notification (not being less than sixty days from the date of the notification) or, if no date is specified in respect of any such territory, on the sixtieth day after the date of such notification, unless, prior to the date on which the Convention would otherwise become applicable to a particular territory, the Contracting Party to whom notification is given shall have informed the other Contracting Party in writing through diplomatic channels that it does not accept such notification as to that territory. In the absence of such extension, the present Convention shall not apply to any such territory.

(2) At any time after the expiration of one year from the entry into force of an extension under paragraph (1) of this Article, either of the Contracting Parties may, by written notice of termination given to the other Contracting Party through diplomatic channels, terminate the application of the present Convention to any territory to which it has been extended under paragraph (1), and in such event the present Convention shall cease to apply, six months after the date of such notice, to the territory or territories named therein, but

without affecting its continued application to the United States, the United Kingdom or to any other territory to which it has been extended under paragraph (1) hereof.

(3) In the application of the present Convention in relation to any territory to which it is extended by notification by the United States or the United Kingdom references to the "United States" or, as the case may be, the "United Kingdom" shall be construed as references to that territory.

(4) The termination in respect of the United States or the United Kingdom of the present Convention under Article XXIV or of Article VI shall, unless otherwise expressly agreed by both Contracting Parties, terminate the application of the present Convention or, as the case may be, that Article to any territory to which the Convention has been extended by the United States or the United Kingdom.

(5) The provisions of the preceding paragraphs of this Article shall apply to the Channel Islands and the Isle of Man as if they were colonies of the United Kingdom.

ARTICLE XXIII

(1) The present Convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) Upon exchange of ratifications, the present Convention shall have effect

(a) as respects United States tax, for the taxable years beginning on or after the first day of January 1945;

(b) (i) as respects United Kingdom income tax, for the year of assessment beginning on the 6th day of April 1945 and subsequent years; (ii) as respects United Kingdom surtax, for the year of assessment beginning on the 6th day of April 1944 and subsequent years; and (iii) as respects United Kingdom excess profits tax and national defence contribution, for any chargeable accounting period beginning on or after the first day of April 1945 and for the unexpired portion of any chargeable accounting period current at that date.

ARTICLE XXIV

(1) The present Convention shall continue in effect indefinitely but either of the Contracting Parties may, on or before the 30th day of June in any year after the year 1946, give to the other Contracting Party, through diplomatic channels, notice of termination and, in such event, the present Convention shall cease to be effective

(a) as respects United States tax, for the taxable years beginning on or after the first day of January in the year next following that in which such notice is given;

(b) (i) as respects United Kingdom income tax, for any year of assessment beginning on or after the 6th day of April in the year next following that in which such notice is given; (ii) as respects United Kingdom surtax, for any year of assessment beginning on or after the 6th day of April in the year in which such notice is given; and (iii) as respects United Kingdom excess profits

tax and national defence contribution, for any chargeable accounting period beginning on or after the first day of April in the year next following that in which such notice is given and for the unexpired portion of any chargeable accounting period current at that date.

(2) The termination of the present Convention or of any Article thereof shall not have the effect of reviving any treaty or arrangement abrogated by the present Convention or by treaties previously concluded between the Contracting Parties.

IN WITNESS WHEREOF the above-mentioned Plenipotentiaries have signed the present Convention and have affixed thereto their seals.

Done at Washington, in duplicate, on the 16th day of April, 1945.

For the Government of the United States of America:

E. R. STETTINIUS, Jr.

For the Government of the United Kingdom of Great Britain and Northern Ireland:

HALIFAX.